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Telephony

INTEGRATING VOICE AND DATA COMMUNICATIONS

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'WE HAVE MADE PROGRESS' On the eve of USTA's 90th convention, incoming Chairman Carl Bailey discusses the industry and his USTA agenda

IBM MOUNTS PBX CHALLENGE
With a new system, IBM vies for U.S. and international market edge

NORTHERN TELECOM BUYS STC STAKE
The switch supplier gains small foothold in European market

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South Central Bell Telephone President and CEO Carl F. Bailey steps into the USTA chairmanship at this year's annual meeting Oct. 13-15 in Orlando, Fla. As he discusses with Editor Larry Lannon in an exclusive interview, he is ready for the job. All photos, including cover, by Bud Hunter

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A Comparative Study: LEC Depreciation in 1986

DAVID J. MORGAN

DEPRECIATION is one generally accepted cost of doing business. Telephone companies record depreciation expense as part of their annual operating costs.

This expense plays two important roles: It is part of the utility's internally generated funds used to modernize telephone plant and equipment, and it is a cost component in the calculation of local telephone-service rates. Determining the correct amount of depreciation insures the best possible telephone service at the best possible price.

The United States Telephone Association engineering subcommittee on depreciation recently reviewed the depreciation expense activity of the 14 largest domestic local exchange carriers. These LECs represent approximately 95% of the total local exchange industry.

To assist in the review, the subcommittee asked an industry ad hoc capital-recovery methods group to collect publicly available depreciation data from each of the major LECs. The information was prepared on a holding company basis; additional depreciation data, detailed by state and operating company, was also collected.

1986 Activity

During 1986, the largest LECs recorded $14.8 billion in depreciation expenses. This amount represents an annual composite depreciation rate of 7.6%. The composite rate is a weighted mix of the depreciation rates for each class or type of telephone plant and equipment. The depreciation rate is the percentage applied to the plant and equipment dollar accounts to determine the amount of depreciation expense for an accounting period. Each type of telephone plant or equipment account may have a different depreciation rate due to the length of time each type is economically or functionally useful.

The historical total depreciation for the major LECs at year-end 1986 was $57.1 billion, or 28.5% of the total year-end depreciable plant balance of $199.9 billion. This percentage is referred to as the reserve ratio. It is the ratio of the historical depreciation reserve accounts to the capital investment balance in the related asset accounts.

The objective of depreciating is to recover 100% of the original cost of the plant equipment in the time between its installation and retirement. During 1986, the major LECs retired $6.9 billion of old or obsolete plant and equipment. As a percentage of average annual depreciable assets, this is a retirement ratio of 3.6%.

Each major LEC furnished a summary of its year-end plant balances, reserve balances, depreciation accruals and annual retirement amounts. The information was given

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TABLE 1 LEC DEPRECIATION INDEXES

DOMESTIC TELEPHONE OPERATIONS		1986 YR BEGIN PLT BAL	1986 YR END PLT BAL	1986 AVERAGE PLT BAL	1986 RESERVE BALANCE	1986 TOTAL ACCRUAL	1986 TOTAL RETIRES	1986 COMPOSITE DEPR RATE	1986 RESERVE RATIO	1986 RETIREMENT RATIO
ALLTEL	AL	$1692	$1766	$1729	$595	$107	$84	6.2%	33.7%	4.9%
AMERITECH	AM	20,526	21,887	21,207	6964	1653	687	7.8	31.8	3.2
BELL ATLANTIC	BA	21,322	22,874	22,098	6739	1891	706	8.6	29.5	3.2
BELLSOUTH	BS	26,230	28,214	27,222	7123	2044	768	7.5	25.2	2.8
CINCINNATI BELL	CB	1042	1096	1069	339	74	46	6.9	30.9	4.3
CENTEL	CE	2096	2129	2113	681	150	94	7.1	32.0	4.4
CONTEL	CO	4231	4544	4388	1356	326	194	7.4	29.8	4.4
GTE	GT	21,106	22,300	21,703	6686	1783	1233	8.2	30.0	5.7
NYNEX	NX	22,399	23,535	22,967	7083	1595	850	6.9	30.1	3.7
PACIFIC TELESIS	PT	19,885	21,671	20,478	5368	1567	604	7.7	25.5	2.9
SNET	SN	2704	2826	2765	1026	197	87	7.1	36.3	3.1
SW BELL	SB	19,629	21,055	20,342	5080	1423	627	7.0	24.1	3.1
UNITED	UN	5856	6063	5960	2193	497	377	8.3	36.2	6.3
U S WEST	US	19,367	20,548	19,958	5821	1494	599	7.5	28.3	3.0
Major Telcos (PR Basis)		$188,085	$199,908	$193,996	$57,054	$14,802	$6956	7.6%	28.5%	3.6%

for each company in each state. From the data, the three key depreciation indexes were computed and examined: depreciation rate, reserve ratio and retirement ratio. Indexes were derived for each company and for the local exchange industry (Table 1). Figures 1, 2 and 3 were derived from this data.

The timely depreciation of telephone plant and equipment is paramount. All parties involved in telephone service will recognize the benefits of a progressive depreciation process as the telephone industry continues to use new technologies in providing new services. □

Glossary

Depreciation Rate:

1. The depreciation rate level is a function of the service life of the plant or equipment.
2. A higher rate of depreciation increases the reserve ratio.

Retirement Ratio:

1. Technology-/and service-demand requirements may drive plant and equipment modernization programs. Accelerated economic or functional obsolescence may produce higher amounts of retirements.
2. Retirements of plant and equipment decrease the depreciation reserve ratio.

Reserve Ratio:

1. A higher reserve ratio may indicate older plant and equipment that has not been subject to many retirements.
2. A higher reserve ratio may show depreciation rate results from a favorable preparation plan accompanying an aggressive modernization program.
3. A lower reserve ratio may indicate inadequate historical depreciation rates.
4. A lower reserve ratio may result from an aggressive modernization program without adequate depreciation rates.

FIGURE 1
MAJOR U.S. TELCOS
1986 Composite Depreciation Rates

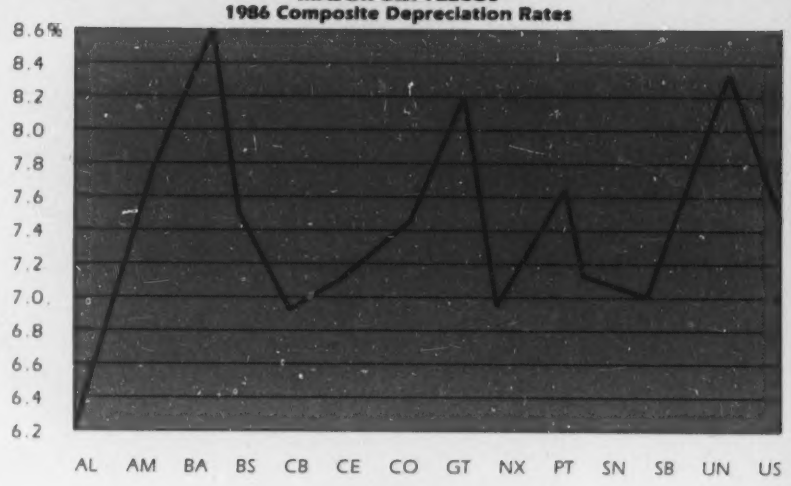

FIGURE 2
MAJOR U.S. TELCOS
1986 Retirement Ratios

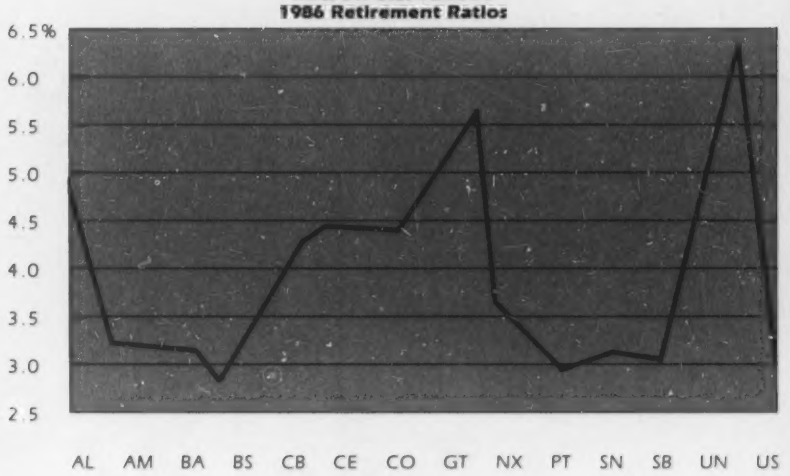

FIGURE 3
MAJOR U.S. TELCOS
1986 Reserve Ratios